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**Supreme Court of the United States**

OCTOBER TERM—1946

No. 410

THE CHICAGO, ROCK ISLAND AND PACIFIC  
RAILWAY COMPANY,

*Petitioner,*

*against*

JOSEPH B. FLEMING and AARON COLNON as Trustees of The  
Chicago, Rock Island and Pacific Railway Company,  
et al.,

*Respondents.*

**PETITION FOR WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE  
SEVENTH CIRCUIT.**

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

*To the Honorable Chief Justice and the  
Associate Justices of the Supreme Court  
of the United States:*

Your petitioner, the debtor in the above titled proceedings, respectfully prays that a writ of certiorari issue to review an order and decree of the United States Circuit Court of Appeals for the Seventh Circuit (R. 355), which was entered in the above cause on May 23, 1946, and which affirmed an order of the United States District Court for the Northern District of Illinois, Eastern Division, entered June 15, 1945 (R. 309-316), approving a plan of reorganization of the debtor.

### **Opinions Below**

The opinion of the United States District Court for the Northern District of Illinois, Eastern Division (R. 301-308) was filed on May 14, 1945; it has not been reported. The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 343-355) was filed on May 23, 1946, and is reported in 155 F. (2d) 489.

### **Jurisdiction**

The order and decree of the United States Circuit Court of Appeals for the Seventh Circuit, sought to be reviewed, was entered on May 23, 1946. Jurisdiction to issue the writ requested is found in the provisions of Section 24(c) of the Bankruptcy Act and Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U.S.C.A. Sec. 347(a)).

### **Statute Involved**

The pertinent provisions of the Bankruptcy Act, as amended, are found in the Appendix, *infra*, pages 14 to 17.

### **Statement**

The Interstate Commerce Commission issued and approved a plan of reorganization of the debtor herein by its report and order dated October 31, 1940 (R. 31-161). It subsequently made certain modifications and corrected certain errors and inconsistencies in this plan by orders and reports dated July 31, 1941 (R. 162-196), October 2, 1941 (R. 197-200), and April 6, 1942 (R. 201-226). Hearings on the approval of this plan (which was to be effective as of January 1, 1942), and on objections to the plan, were held before the District Court.

The District Court, in its opinion dated June 3, 1943 (R. 261-297), found all objections to the plan so approved by the Commission to be "without merit with two exceptions. These are

"(a) The claim of discrimination arising from the distribution of new common stock to the First & Refunding bondholders because of their second lien on the General Mortgage properties. The Commission should determine what, if any, portion, of the 335,844.2 shares of new common stock allotted to the First & Refunding bonds, should be allotted to the General Mortgage bonds, in addition to the securities allotted to them under the plan, in order to afford full compensatory treatment to the General Mortgage bonds; and

"(b) The provisions of the plan relative to the appointment of reorganization managers. For the reasons heretofore given, the Court concludes that said provisions of the plan are not fair and equitable." (R. 297.)

In its order of June 25, 1943 (R. 299-300), the Court referred these matters to the Commission for further consideration.

With the two exceptions noted, the Court concluded "that the provisions of the plan comply with subsection (b) of Section 77 of the Bankruptcy Act, that the plan is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders." (R. 297.)

As the debtor's estate would, as of January 1, 1944, have a large surplus of cash on hand because of net profits in

the calendar years 1942 and 1943\*, the Court, in its order of June 25, 1943, also requested the Commission (R. 300) to determine the distribution to be made among creditors of the anticipated surplus cash of the debtor and of such of the new securities originally intended to provide cash working capital as would no longer be needed for that purpose.

The Commission held hearings to consider the matters referred to it, as aforesaid, by the Court. It gave its attention *solely* to these matters, and refused to consider any other material modifications in the plan, saying, "approval of either the debtor's proposal or of the convertible bondholders' group's proposal would necessitate material modification in the plan and, in our opinion, is not warranted" (R. 234).

As a result of its consideration of the matters referred to it by the Court, the Commission, in its report of January 3, 1944 (R. 227-248):

1. Held that holders of General Mortgage Bonds receive full compensatory treatment under the plan (detailed discussion R. 237-243; summary conclusion, last paragraph of R. 242).

2. Provided that the appointment of members of the reorganization committee be subject to the ratification of the Court (R. 246).

3. Postponed the effective date of the plan from January 1, 1942 to January 1, 1944 (R. 230-232).

4. Found that additional new first mortgage bonds in the principal amount of \$12,409,600 are available for distribution to creditors because the net earnings for 1942 and 1943 have made their issuance no longer necessary to pro-

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\* Profits of more than \$72,000,000 were actually realized in these years (R. 303).



vide new money for the reorganized debtor or to pay accrued interest on some of the senior securities (R. 232); and provided that said \$12,409,600 of additional bonds should be distributed by "the method approved for the distribution of the other new first mortgage bonds under the plan [effective as of January 1, 1942], that is, on the basis of the relative adjusted earnings of the respective mortgaged properties for 1936 and 1937" (R. 234). (Material in brackets has been added.)

5. Found that cash in the amount of \$38,011,922 was available for distribution as a result of the 1942 and 1943 net earnings of the debtor, and that such cash should be distributed as eight years of interest on the new first mortgage bonds, four years of interest on the new contingent interest bonds, two years of dividends on the new preferred stock, and \$2.50 per share on the new common stock (R. 234-235).

The Commission did *not*, in the plan effective as of January 1, 1944, change any allotment of securities made in the plan effective as of January 1, 1942, with the exception of the addition of the new first mortgage bonds allotted under the proposed distribution described in the foregoing paragraph numbered "4". (Compare the allotments of new income bonds, preferred stock and common stock at R. 220-221 with the allotments at R. 259.)

The United States District Court for the Northern District of Illinois, Eastern Division, by its order of June 15, 1945 (R. 309-316), approved the plan of reorganization which embodies the foregoing conclusions of the Commission; and the United States Circuit Court of Appeals for the Seventh Circuit, by its order and decree entered May 23, 1946 (R. 355), affirmed said order of the District Court dated June 15, 1945.

The debtor contested the validity of the aforesaid proposed distribution of \$12,409,600 of new first mortgage

bonds and \$38,011,922 of cash, at the hearings before the Commission (R. 318-319), at the hearings before the United States District Court (R. 330-331), and on its appeal to the United States Circuit Court of Appeals for the Seventh Circuit (R. 336).

### Questions Presented

The review requested herein raises questions as to the legal and equitable standards to be applied in the distribution among creditors of securities and cash of the debtor—available for distribution because of net earnings during the period of postponement—when the effective date of a plan of reorganization is postponed two years.

In *R.F.C. v. Denver & Rio Grande Western Rr.*, 90 Law. ed. (Advance Opinions) 1134, this Court held that where there has been an allocation of securities under a plan, those to whom the securities are allotted are entitled, after the date as of which the securities are to be delivered, to all the rights subsequently accruing under the terms of the securities thus allotted. Creditors allotted new common stock are thereafter entitled to the benefit of all earnings which are in excess of the amounts necessary to meet interest and charges on new senior obligations. Those allotted common stock are entitled to divide the earnings of "lush years" (p. 1146). If there is more cash on hand than needed for taxes, expenses, interest on bonds, dividends on preferred stock, and proper improvements, it is at the disposal of the common stockholders.

"There is another important factor, corollary to stock ownership, to be noted in the Commission's allocation of these securities. This factor is that the creditors who received common stock to make them whole obtained with that common stock an interest in all cash on hand or all cash that might be accumulated. \* \* \* If there is more cash on hand

than needed, for taxes, expenses and proper improvements, it is at the disposal of the common stockholders." (p. 1146-1147).

" \* \* \* Assets in the balance sheet at the adoption of the plan, and subsequent earnings, are, as we have pointed out, for the benefit of the stockholders in the new company so that through these common stock advantages these new stockholders may be compensated for their loss of payment in full in cash." (p. 1150).

In its opinion this Court also held that new securities released by the payment of senior indebtedness after the effective date should not be distributed to the old creditors, senior or junior, but should be disposed of for the benefit of the holders of the new common stock, whose assets were used in the retirement of such debt.

"Under our determination that the creditors who received common stock were compensated partly by the assets and future earnings, it is obvious that the use of such assets to retire senior claims is a part of the normal and expected increment from holdings of common stock." (p. 1150).

The foregoing principles were not applied in the distributions made in this case.

In the plan approved herein, it is not proposed that the \$12,409,600 of additional first mortgage bonds, available for distribution because of the net earnings of the debtor in 1942 and 1943, be distributed in accordance with the rights created by the new securities allotted under the plan, but according to "the method approved for the distribution of the other new first mortgage bonds under the Plan, that is, on the basis of the relative adjusted earnings of the respective mortgaged properties for 1936 and 1937" (R. 234). On this basis, creditors previously allotted

\$18,507,460 of the new first mortgage bonds are to receive an additional \$12,409,600 of such bonds although the interest on their bonds for the period of the two year extension of effective date is only \$1,400,596.80.

Nor is it proposed that the \$38,011,922 of cash be distributed as two years of earnings under the terms of the new securities allotted, although the cash was actually earned during the two year period of the extended effective date. On the contrary, it is proposed that the cash be distributed as a wholly arbitrary payment of eight years of interest on the new first mortgage bonds, four years of interest on the new income bonds, two years of dividends on the new preferred stock, and \$2.50 per share on the new common stock. On this basis creditors allotted new first mortgage bonds will receive four times as much as they are entitled to and creditors allotted new income bonds will receive twice as much as they are entitled to, while creditors allotted new common stock will only receive approximately 11% of what they should receive.

The questions are:

1. Is the proposed distribution of \$12,409,600 of new first mortgage bonds in accordance with proper legal and equitable standards?
2. Is the proposed distribution of \$38,011,922 of cash in accordance with proper legal and equitable standards?

### **Specification of Errors to be Urged**

The debtor respectfully submits that the Commission and the courts below erred:

1. In the proposed distribution of \$12,409,600 of additional new first mortgage bonds, available for distribution because of the net earnings of the debtor in 1942 and 1943.

2. In the proposed distribution of \$38,011,922 of cash, available for distribution because of the net earnings of the debtor in 1942 and 1943.

### Argument

It is the contention of the debtor that the proposed distributions are illegal and inequitable, and violate the standards fixed by this Court in the *Denver & Rio Grande* case, 90 Law. ed. (Advance Opinions) 1134.

As the Commission, on its reconsideration of the plan, refused to reappraise the entire situation, revalue the claims of the old creditors, and reallocate the new securities provided under the plan, it is clear that its valuations all relate back to January 1, 1942, the effective date of the original plan. This date is the Rock Island equivalent of the "effective date" referred to in the *Denver Rio Grande* decision—it is the date at which the rights of those allotted shares of the new common stock and other securities became fixed.

The cash fund which made it unnecessary to issue the \$12,409,600 of new first mortgage bonds to provide new working capital was either "assets in the balance sheet" on January 1, 1942, or "subsequent earnings" (*Denver & Rio Grande* opinion, p. 1150). In either case these bonds should be applied "for the benefit of the stockholders in the new company" (p. 1150), after payment of interest and dividends on the new bonds and preferred stock.

So, too, the \$38,011,922 of cash available for distribution on December 31, 1943, was either "assets in the balance sheet" on January 1, 1942, or "subsequent earnings"; in either of which events it should be distributed to the "stockholders in the new company" after payment of interest and dividends on the new bonds and preferred stock.

The proposed distribution of said securities and cash in the plan is not made on the basis of the allotment of the new securities of the debtor. Instead, the distribution is made primarily to the old senior creditors in complete disregard of the doctrine of the *Denver & Rio Grande* decision.

The following table demonstrates the illegality of the combined proposed distribution of the \$12,409,600 of additional new first mortgage bonds and \$38,011,922 cash approved by the Commission and the courts below:

	Distribution Proposed in Plan*	Distribution under Denver & Rio Grande Doctrine**	Proposed Distribution compared with Distribution under Denver & Rio Grande Doctrine
General Mortgage .....	\$249.36	\$166.15	150%
First & Ref. ....	135.51	162.33	83%
Secured 4½s .....	152.45	182.42	84%
C. O. & G. ....	195.03	143.63	136%
St. P. & K. C. S. L. ....	87.97	165.95	53%
Rial .....	174.69	152.04	114%
L. R. & H. S. W. ....	116.84	49.62	235%
B. C. R. & N. ....	56.20	150.20	37%
Convertible 4½s .....	12.42	95.33	13%
General Creditors .....	12.42	95.33	13%

\* These figures consist, in each instance, of the sum of the cash proposed to be paid and the additional new first mortgage bonds proposed to be allotted, per \$1,000 principal amount of claim.

\*\* These amounts were fixed as follows: From the total of \$50,421,522 of new first mortgage bonds and cash available for distribution, interest on the new bonds and dividends on the new preferred stock (in each case, for two years) were deducted; the balance was then apportioned to the new common stock (amounting to approximately \$22. per share); each \$1,000 of principal amount of old claims was then credited with the amounts receivable as interest and dividends on the new bonds and shares allotted to it.

As an alternative to a distribution based on giving effect to the terms of the new securities allotted in the plan (herein referred to as the "*Denver & Rio Grande Doctrine*"), it may be argued that distribution may legally and equitably be based on the terms of the old securities

(hereinafter referred to as the "*Milwaukee Doctrine*"). Under such a distribution, the amounts distributable as interest on the old bonds, for the two year period of postponement of effective date, compared with the distribution approved herein by the Commission and courts, would be as follows, per \$1,000 principal amount of claim:

	Distribution Proposed in Plan	Distribution under Milwaukee Doctrine	Proposed Distribution compared with Distribution under Milwaukee Doctrine
General Mortgage .....	\$249.36	\$ 80.00	311.7%
First & Ref. ....	135.51	80.00	169.4%
Secured 4½s .....	152.45	90.00	169.4%
C. O. & G. ....	195.03	100.00	195 %
St. P. & K. C. S. L. ....	87.97	90.00	97.5%
Rial .....	174.69	90.00	194.1%
L. R. & H. S. W. ....	116.84	80.00	146 %
B. C. R. & N. ....	56.20	100.00	56.2%
Convertible 4½s .....	12.42	90.00	13.6%
Gen'l Creditors .....	12.42		

The Milwaukee Doctrine was upheld by the United States Circuit Court of Appeals for the Seventh Circuit in *In re Chicago, Milwaukee, St. Paul & Pacific Rr. Co.*, 145 F(2d) 299, (cert. denied, 324 U.S. 857), at page 302. It was also applied herein by the Commission in its distribution of \$17,000,000 of additionally authorized securities when it changed the effective date of the plan from January 1, 1941 to January 1, 1942 (report of Commission dated July 31, 1941 — R. 162-196).

### Reasons for Granting the Writ

1. The decision below presents an important question in reorganization proceedings, particularly proceedings under the Bankruptcy Act. Until this question is settled



by this Court, substantial confusion will exist in determining the disposition to be made of the income of debtors during the pendency of reorganization proceedings, especially where circumstances make it desirable to postpone the effective date of a plan.

2. The decision of the Commission and the courts below is in conflict with the reasoning of this Court in the *Denver & Rio Grande* case, 90 Law. ed. (Advance Opinions) 1134. It is also in conflict with the distribution approved by the Circuit Court of Appeals for the Seventh Circuit in *In re Chicago, Milwaukee, St. Paul and Pacific Rr. Co.*, 145 F(2d) 299.

### Conclusion

The debtor respectfully submits that the decision of the United States Circuit Court of Appeals for the Seventh Circuit is erroneous, that the questions involved are of general public importance, and that it is in the public interest to have those questions answered as soon as practicable by an authoritative decision of this Court.

Attention of this Court is respectfully called to the fact that after the Circuit Court of Appeals for the Seventh Circuit entered its order and decree affirming the decisions of the Commission and the District Court approving the plan, hearings were held by the United States District Court for the Northern District of Illinois, Eastern Division, on the confirmation of the plan. As a result of such hearings, said District Court duly entered an order herein on June 28, 1946, entitled "ORDER THAT THE PLAN OF REORGANIZATION BE NOT CONFIRMED AND THAT THE CASE BE REFERRED BACK TO THE INTERSTATE COMMERCE COMMISSION FOR FURTHER PROCEEDINGS". Appeals from said order have been taken by various parties to the United States Circuit Court of Appeals for the Seventh Circuit.



So long as the aforesaid order of the District Court entered June 28, 1946, is in effect, the questions as to which the debtor seeks review by this application for a writ of certiorari are moot. It therefore respectfully requests that this Court withhold action on this application for a writ of certiorari until the finality of the order of the District Court entered June 28, 1946 has been determined. This application is filed to preserve the right of the debtor to question the matters herein referred to, if the order of the District Court refusing to confirm the plan is reversed.

WHEREFORE, the debtor respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, directing that Court to certify and send to this Court for its review and determination on a day certain to be named therein a transcript of the record and proceedings herein; that the judgment of said Court be reviewed in so far as it approves the plan of reorganization; and that your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just.

Dated New York, N. Y., August 20, 1946.

JOHN GERDES

HENRY F. TENNEY

*Counsel for Petitioner*

**APPENDIX****The Bankruptcy Act, as amended:**

Sec. 24(c). The Supreme Court of the United States is hereby vested with jurisdiction to review judgments, decrees, and orders of the Circuit Court of Appeals of the United States and the United States Circuit Court of Appeals for the District of Columbia in proceedings under this title in accordance with the provisions of the laws of the United States now in force or such as may hereafter be enacted. (11 U.S.C.A. section 47(c).)

Sec. 77(b). A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise; (3) may include, for the purpose of preserving such interests of creditors and stockholders as are now otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings, experience, and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; (5) shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations,

the retention of all or any part of the property by the debtor, the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens, indentures, or other similar interests, the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, or in satisfaction of claims or rights or for other appropriate purposes; and may deal with all or any part of the property of the debtor; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section. (11 U.S.C.A. section 205(b).)

Sec. 77(d). The debtor, after a petition is filed as provided in subsection (a) of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, or if heretofore approved, then within six months of August 27, 1935, and not thereafter unless such time is extended by the judge from time to time for cause shown, no single extension at any one time to be for more than six months. Such plan shall also be filed with the Commission at the same time. Such plans may likewise be filed at any time before, or with the consent of the Commission during, the hearings hereinafter provided for, by the trustee or trustees, or by or on behalf of the creditors being not less than 10 per centum in amount of any class of creditors, or by or on behalf of any class of stockholders being not less than 10 per centum in amount of any such class, or with the consent of the Commission by any party in interest. After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order

in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be comparable with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court. (11 U.S.C.A. section 205(d).)

Sec. 77(e). Upon the certification of a plan by the Commission to the court, the court shall give notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the ap-

proximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made under or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

• • • • •

If it shall be necessary to determine the value of any property under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts. (11 U.S.C.A. section 205(e).)